Chapter 18

Why—or When—Should we Cross-List our Shares?

Overview

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Outline

Terminology

- **cross-listing, foreign listing**
  - "foreign" often means the foreign listing is the sole one;
  - "cross" always refers to a dual (or multiple) listing;
- **primary, secondary, first, second**
  - primary/secondary *offering*: new v "old" shares being offered
  - primary/secondary *listing*: where the main market is, e.g. with the original shares not the xerox copies.

    In 1994, Jardine Matheson moved its primary listing from Hong Kong to London, and later delisted from HK. Still, its headquarters had been in Bermuda since 1984, and it has a secondary listing in Singapore, where most of the liquidity is. H&SBC, in contrast, maintained its Hong Kong listing but moved both headquarters and its primary listing to London; it later obtained additional listings on NYSE and Euronext.
  - first/second board, "new" mkt, "alternative" mkt: stricter/less strict requirements before and after getting listed

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Possible Gains from Cross-listings (1)

- **Broadening the shareholder base**
  - deep, well-organized market, keen on new stocks
  - promotes dispersion of shares
  - overcoming explicit capital-market barriers
    - (instit.) investor often restricted to locally registered or listed assets
    - issuer may be barred from promoting non-registered stocks
  - investor convenience: trade in local exchange, in HC
- **Getting a better issue price**
  - foreign investors may be better diversified—happy with lower returns

    requires some imperfection that creates home bias at home
  - better corporate-governance environment ⇒ more trust ⇒ higher value
  - (Hi-tech:) Lack of savvy analysts and investment bankers at home?

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Possible Gains from Foreign or Cross-listings (2)

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  - higher volumes? Liquidity is good for both "informed" and "liquidity" traders
  - more analysts? In US, avge foreign stock even has more following than avge US stock (5.7 v 4, in one study)
- **Visibility in goods & factor mkts**
- **Diversification benefits for home investor**
  - local β falls (even though foreign β remains constant (??)), so less diversifiable risk

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Costs of a cross-listing

- **Issue costs**
  - more complete prospectus & due-diligence; translate/revise up to 5 yrs of FS's; advertizing, road shows

    One study: for small issues, HK costs 25%, Shenzen's 2nd board "only" 16%

- **extra recurrent costs to issuer**
  - two or more versions of accounts, FS; more interim reports; listing fees
  - US: SOx 404

- **trading costs, incl price impact:** hard to measure:
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- Big empirical issue: do the observed price gains reflect...
  - gains from “overcoming investment barriers”, or
  - corporate governance (legal bonding, better information, more monitoring), or
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- closer look at diversification case: theory, some estimates
- tests that shed light on issuer’s motivation & view on gains

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Outline

Why would Investors Diversify?

- **Data**
  - data 1980-1999
  - 39 countries:

    Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, China, Colombia, Denmark, Finland, France, Germany, Greece, Hong Kong, India, Indonesia, Ireland, Italy, Japan, Luxemburg, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Peru, Philippines, Portugal, Singapore, South Korea, South-Africa, Spain, Sweden, Switzerland, Taiwan, Thailand, the United Kingdom, and the United States.
  - 34 global sectors

    aerospace. & defense, automation & parts, banks, beverages, chemicals, construction materials, diversified sector, electricity, electro & electric, engineering & machinerie, food & drug retailing, food producers, forestry & paper, household goods & textile, healthcare, IT hardware, insurance, leisure & hotels, life assurance, media & entertainment, mining, oil & gas, personal care & house, pharmaceutical & biotech, real estate, retailer (general), software & services, specialty & financial, steel& other metals, support services, telecom services, tobacco, transport, other utilities.
- **Mean-variance efficient sets**
  - US stocks only, 34 local industry portfolios
  - non-US stocks only, 34 semi-global-industry portfolios
  - all stocks, 34 global-industry portfolios

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    aerospace. & defense, automation & parts, banks, beverages, chemicals, construction materials, diversified sector, electricity, electro & electric, engineering & machinerie, food & drug retailing, food producers, forestry & paper, household goods & textile, healthcare, IT hardware, insurance, leisure & hotels, life assurance, media & entertainment, mining, oil & gas, personal care & house, pharmaceutical & biotech, real estate, retailer (general), software & services, specialty & financial, steel& other metals, support services, telecom services, tobacco, transport, other utilities.
- **Mean-variance efficient sets**
  - US stocks only, 34 local industry portfolios
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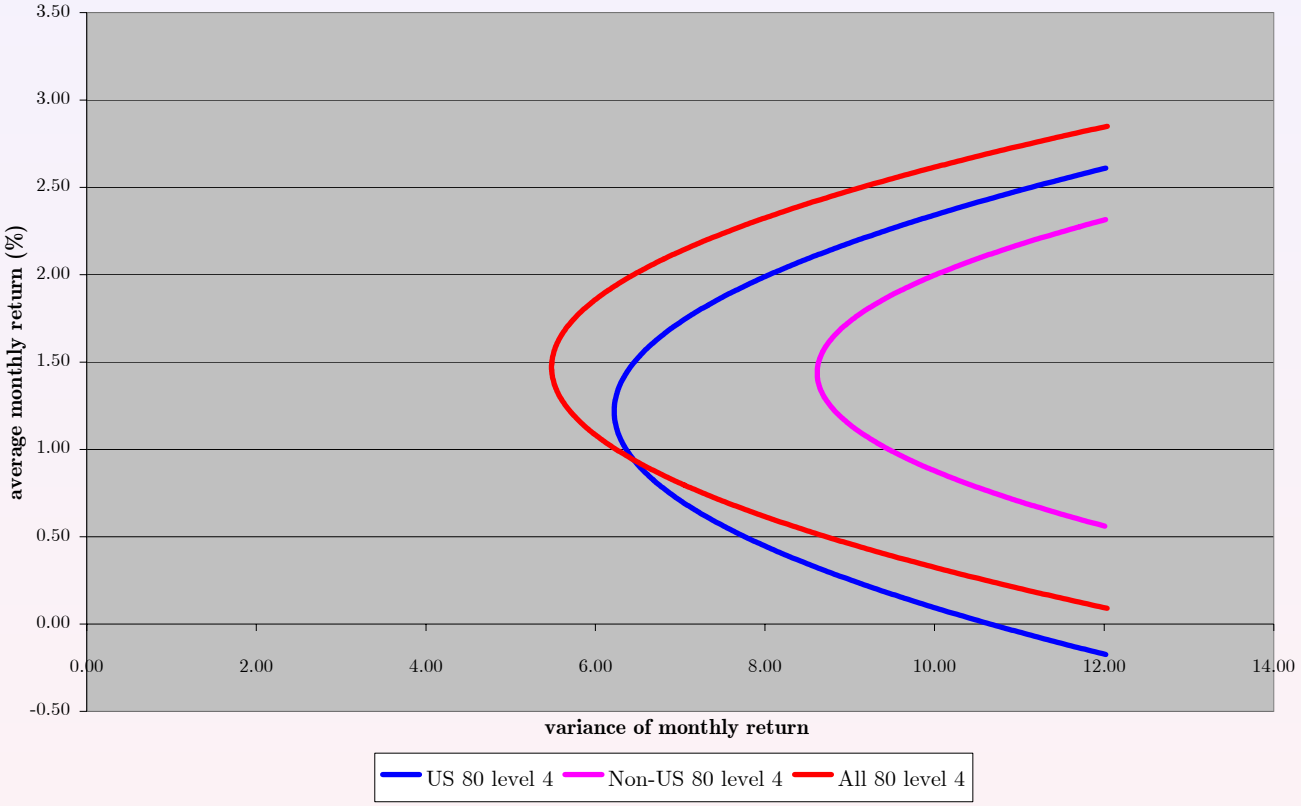
Why would Investors Diversify?: Efficient sets



Key The outer minimum-variance bound is made from 34 world-wide sector portfolios, the middle one from 34 US sector portfolios, and the inner one from 34 non-US sector portfolios.

Why would old shareholders say aye too?

How far can the C/oCap fall? Stulz's lithmus test

- We are interested in expected return of a country's average company—its local market—pre and post integration
- CAPM:
  - expected returns proportional to cov of asset's return with entire portfolio's return
  - pre-integration: entire porfolio *is* local market
  - post-integration: entire porfolio is world market
- So:

post: $\mathrm{E}(\tilde{r}_{M_k} - r_0)_{post} = \eta \,\mathrm{cov}(\tilde{r}_{M_k}, \tilde{r}_w),$

pre: $\mathrm{E}(\tilde{r}_{M_k} - r_0)_{pre} = \eta \,\mathrm{var}(\tilde{r}_{M_k}),$

$$\Rightarrow \quad \frac{\mathrm{E}(\tilde{r}_{M_k} - r_0)_{post}}{\mathrm{E}(\tilde{r}_{M_k} - r_0)_{pre}} < 1 \text{ iff } \underbrace{\frac{\mathrm{cov}(\tilde{r}_{M_k}, \tilde{r}_w)}{\mathrm{var}(\tilde{r}_{M_k})}}_{\substack{\text{regr coeff } \beta \text{ in} \\ \tilde{r}_w = \alpha_w + \beta_w \tilde{r}_{M_k} + \tilde{\epsilon}_w.}} < 1 \text{ and } \textit{vice versa}.$$

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Why would firms prefer global investors?

	β_w	sd(β)	t-stat v $\beta = 1$	$p.a.\ \Delta$ inE($\tilde{r}$)		β	st(β)	t-stat v $\beta = 1$	$p.a.\ \Delta$ in E($\tilde{r}$)
Argentina	0.150	0.033	-25.38	4.25	Malaysia	0.115	0.032	-27.83	4.43
Austria	0.480	0.087	-6.00	2.60	Mexico	0.289	0.036	-19.92	3.55
Brazil	0.142	0.026	-32.56	4.29	Netherlands	0.641	0.045	-8.04	1.79
Belgium	0.554	0.068	-6.55	2.23	Norway	0.533	0.049	-9.60	2.34
Canada	0.427	0.047	-12.14	2.87	Philippines	0.172	0.033	-25.45	4.14
Chile	0.357	0.047	-13.60	3.21	Poland	0.164	0.028	-29.77	4.18
Colombia	0.129	0.051	-17.03	4.35	Portugal	0.380	0.054	-11.38	3.10
Denmark	0.610	0.067	-5.80	1.95	Singapore	0.276	0.032	-22.48	3.62
Finland	0.274	0.031	-23.64	3.63	South Africa	0.214	0.037	-21.14	3.93
France	0.654	0.049	-7.10	1.73	Spain	0.537	0.044	-10.60	2.31
Germany	0.519	0.041	-11.78	2.41	Sweden	0.488	0.037	-13.72	2.56
Greece	0.180	0.038	-21.49	4.10	Switzerland	0.606	0.067	-5.87	1.97
Hong Kong	0.310	0.036	-19.15	3.45	Thailand	0.178	0.026	-31.19	4.11
Indonesia	0.098	0.023	-39.88	4.51	Turkey	0.108	0.019	-47.16	4.46
Israel	0.306	0.040	-17.46	3.47	UK	0.807	0.086	-2.25	0.96
Italy	0.362	0.049	-13.14	3.19	US	0.640	0.046	-7.78	1.80
Japan	0.452	0.049	-11.21	2.74	Venezuela	0.088	0.025	-36.71	4.56
Korea	0.165	0.023	-36.54	4.18	**average**	**0.354**			**3.23**

Outline

The 1980-2000 Conventional Wisdom

- **liquidity:**
  - spreads fall
  - volume up
  - $\pm$ no rise in volatility
- **home and foreign β: non-US firm listed in US**
  - home β falls, but sensitivity to US market is not noticeably higher.

    The fall is strongest for Asian issuers, weaker for Continental European ones, and weakest for the UK cies.
  - Using the home β as input into the CAPM, the cost of capital would fall by about 1.25 percent on average—ranging between 0.33% (Europe) and 2% (Asia).
- **home and foreign β: US firm listed elsewhere:**
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1. The observed price reactions, upon announcing a cross-listing, seem small against the estimated drop in the cost of capital.
2. If non-US firms can easily increase their market value this way, how come only ten percent of non-US firms go for a US listing?
3. If the gain stems from overcoming inv barriers, how come that Canadian firms gain as much as others? (market *is* well integrated with US)
4. With increasing integration (better information, disappearing capital restrictions, falling home bias), the number of foreign listings should have fallen as of 1990s. In reality it is has not.
5. The rise is larger for exchange-traded instruments (2.6% instead of 1%!) and smaller for secondary offerings. Yet these distinctions have no obvious link with market segmentation.
6. How come US stocks do not gain from a foreign listing, despite our results from efficient set and Stulz' β.

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(1) is it about Corp Gov and legal bonding?

- VIEW: *"Cross-listing represents an opportunity to improve a firm's corporate governance system. By cross-listing, management and/or its large, controlling shareholders can "bond" themselves to a legal system with more effective protection for minority shareholders against managerial self-dealing or excess consumption of private benefits of control."*
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Evidence in favor of Legal-Bonding view

- Size of value gains: Smaller gains for private and OTC placements than for Level II-III ADRs and shares.
- Who does come? Companies coming to US, esp. to major exchanges, typically come from countries with poorer legal protection. In addition, they then typically do follow-up equity issues at home.
- Extra value? The Tobin's Q premium of cross-listed firms relative to similar firms from across the world is higher (i) when investor protection in the home country is poor, (ii) when the growth prospects are high and shareholder protection is poor (an interaction); (iii) when the issue is exchange-listed (37 percent extra value!) rather than a private or OTC-traded one.
- The value of control, as inferred from the voting premium in dual-class shares, is 43 percent lower for 137 firms cross-listed firms in the US than for 745 comparable domestic firms. Likewise, for 37 dual-share firms that started their cross-listing somewhere in the sample period, the value of the votes fell. Also, firms with dominant shareholders are less likely to seek a cross-listing, *ceteris paribus*.
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- The value of control, as inferred from the voting premium in dual-class shares, is 43 percent lower for 137 firms cross-listed firms in the US than for 745 comparable domestic firms. Likewise, for 37 dual-share firms that started their cross-listing somewhere in the sample period, the value of the votes fell. Also, firms with dominant shareholders are less likely to seek a cross-listing, *ceteris paribus*.
- Insider trading? Mexican firms without ADRs pre-react about 30 days prior to earnings annoucements, suggesting widespread insider dealing. The problem is much reduced for firms that have a cross-listing in the US.

Evidence in favor of Legal-Bonding view

- Size of value gains: Smaller gains for private and OTC placements than for Level II-III ADRs and shares.
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Where the Legal-Bonding tale falls short

- Is it just laws? The SEC rarely goes for foreign companies; at best, there is an out-of-court settlement.
- Canada not integrated?? The extra Tobin's Q premium for (Canadian) cross-listees is noticeable only for firms that list large fractions of their equity in the US—but why would legal bonding be tied to the fraction of equity listed in the US?
- Is voting premium a measure of private benefits?
- How "American" is an ADR? When a foreign firm with a listed ADR takes over a US company, the probability that it uses equity as the means of payment, as opposed to cash, still depends on the home country's legal protection; under the bonding view, the US legal environment should be the sole determinant.
- What's the CorpGov gain from an 144a issue? There is an extra Tobin's Q premium for cross-listees even if the US issue is just a Rule 144a private placement, without any noteworthy legal bonding.

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(2) Or is it just better information?

VIEW *"When firms raise funds from public markets, they must not only provide extensive disclosure at the time of issuance, but also commit to furnish information on an ongoing basis. The more information they provide and the stronger the commitment to provide it continuously, the less costly it is for investors to monitor management and, hence, the more favorable the terms and conditions of financing.*

Cross-listing on an exchange with extensive disclosure requirements is one credible way for companies from around the world to commit to extensive and continuous disclosure."

(2) Evidence on the information story

- no announcement effect for US firms that cross-list abroad!
- Firms that cross-list on the NYSE get more analysts' and media coverage than firms that go for the (less expensive) LSE, suggesting that this is one of the objectives of the NYSE listing.
- The pre-cross-listing run-up and post-cross-listing decline ("visibility effect") is much stronger on the NYSE then on the LSE.
- Analyst attention? Relative to comparable domestic firms, cross-listed companies have more analysts following them; the analysts provide more accurate earnings forecasts; market values are higher; and price reactions to earnings announcements are more pronounced.

  These effects get stronger the weaker the minority-protection rules are at home or the larger the holdings of dominant shareholders. (But: why strong effects for Rule 144a or OTC issues?)

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- US institutional investors are keener on firms that report according to US GAAP; and switching to US GAAP attracts more such investors.
- European companies that cross-list in the US rather than on an another European exchange are typically hi-tech, hi-growth ones, where information asymmetries are rife and the value of analysts coverage is correspondingly high.

  Within Europe, though, firms tend to go to countries with similar cultures (German, Latin, Anglo) or to G5 countries or countries that are geographically close by. So intra-European cross-listings may be chosen in light of minimal information-transmission costs.

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(4) The monitoring role of capital markets

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Large institutional investors, which can also serve an effective monitoring role, are significantly more likely to invest in non-U.S. equities that cross-list as ADRs. Finally, a more active take-over market—which can act as an external monitoring device for managers of poorly performing firms—develops for non-U.S. firms that cross-list their shares in the U.S.

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(4) Monitoring (a): investment banks

Investment banks certify information about the listee, and stake their reputation. The higher the bank's reputation, the higher the cost of lying and the more credible the certificate.

- Domestic SEO announcements tend to trigger price drops; but multiple-market Global Equity Offerings (GEO's) experience smaller price drops despite their higher costs to the company; the before-cost effect could even have been a price rise.
- Domestic equity offerings tend to have a poor long-run post-issue performance, possibly reflecting market timing by managers. This also occurs for GEO, but far less so when the issuer is from an emerging country or the issue is listed (level II-III)—cases where the certification is more important relative to the brief visibility/investor-recognition effect.

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(4) Monitoring (b): large shareholders

New, large active shareholders Large subscribers might also act as a monitors; and, unlike the traditional dominant domestic shareholders, they act at arm's length.

ADRs are better at attracting US institutionals as investors than non-cross-listed ("ordinary") foreign shares:

- Of US-cross-listees, 17% of the equity is on average held by Americans, against 3% for non-cross-listed foreign shares.
- Especially for countries with poor shareholder protection, low liquidity, high transaction costs or low analyst coverage, mutual funds almost exclusively go for ADRs instead of ordinaries. (Incidentally, the ADR effect does not wipe out the negative effect from having a large domestic shareholder, which confirms that legal bonding via a US cross-listing is an imperfect solution.)

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Things to remember from this chapter

- **Why cross-list**
  - only way, or better way, to reach new shareholders
  - better issue price: lower C/oCap, better analysis, better Corp Gov
  - more efficient prices afterwards
  - “business card”
  - indirect diversification benefits for domestic investors
  - BUT: costs
- **The traditional view: diversification pays**
  - new shareholders get same return for less risk
  - old shareholders should gain as C/oCap falls and price rises
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  - bonding to a legal system that does protect minority shareholders
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